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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	**CC Docket No. 96-45**
	)	
Multi-Association Group (MAG) Plan Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	**CC Docket No. 00-256**

REPLY COMMENTS OF THE ALLIANCE OF INCUMBENT RURAL INDEPENDENT TELEPHONE COMPANIES

The Alliance of Incumbent Rural Independent Telephone ("AIRIT") Companies hereby submits these Reply Comments in response to the Commission's *Further Notice of Proposed Rulemaking* in the above-captioned proceeding.[1] In its *Further Notice*, the Commission sought comments on its decision to reject the Rural Task Force's proposal to freeze high-cost loop support on a per-line basis in rural carrier study areas where a competitive eligible telecommunications carrier (ETC) initiates service.[2] In particular, the Commission asks whether, absent a per-line freeze, the growth in the Universal Service Fund ("USF") would be excessive during the period of an interim five-year plan for high cost support for rural telephone companies. In the *Order*, the Commission stated that it was not convinced that excessive fund growth would

[1] *Fourteenth Report and Order, Twenty-Second Order on Reconsideration* ("*Order*"), *and Further Notice of Proposed Rulemaking* ("*Further Notice*"), In the Matter of Federal-State Joint Board on Universal Services, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carrier and Interexchange Carriers, CC Docket Nos. 96-45 and 00-256, FCC 01-157 (rel. May 23, 2001).

[2] *Further Notice* at para. 207.

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occur as a result of competitive ETC ("CETC") entry into rural markets. Nonetheless, by the *Further Notice*, the Commission seeks input on its conclusion as to the freeze and fund growth.[3]

The AIRIT Companies agree with the majority of commenting parties who support the Commission's decision not to freeze the USF per-line high cost support for rural areas during the five-year plan.[4] As has been demonstrated, the record fails to show that excessive fund growth will occur. Moreover, the contemplated per-line freeze neglects, and would not address, fundamental flaws in the mechanisms for USF disbursements. Finally, a freeze would thwart the intent of Section 254 of the Telecommunications Act of 1996 ("Act"), in particular, that universal service support be "sufficient."[5] A per-line freeze would limit support to rural ILECs, thereby hampering their ability to provide access to telecommunications services in rural areas on par with urban areas, in contravention of Section 254(b)(3) of the Act.[6]

I. THE ISSUE IS RATIONAL COST RECOVERY, NOT THE SIZE OF THE FUND

As numerous parties have explained, the proper focus should be on the level of cost recovery support to incumbent ETCs and CETCs that is necessary and sufficient to achieve the intended public interest objectives, rather than on the size of the fund.[7] Rather than deprive incumbent ETCs of "sufficient" universal service support, the Commission should address the

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[3] *Further Notice* at para. 209.

[4] *See, generally*, comments filed on July 30, 2001, in the above captioned proceeding by NTCA, GVNW, NRTA/OPASTCO, Montana Telephone Association, Telecom Consulting Associates, Small Western LECs, and the Nebraska Rural Independents.

[5] 47 U.S.C. § 254(e).

[6] 47 U.S.C. § 254(b)(3).

[7] In this regard, the Illinois Commerce Commission's request for reconsideration of the Commission's *Order* is also misplaced, as it focuses single-mindedly on the size of the fund. *See* Petition for Reconsideration of the Illinois Commerce Commission filed July 5, 2001, in CC Docket No. 96-45.

actual causes of the potentially excessive fund growth. First, the manner in which USF funds would be calculated and distributed to ETCs (*i.e.*, on a "per-line-served" basis) is not quantitatively related to the high costs for which incumbent and competitive ETCs actually require cost recovery support.[8] More specifically, potentially excessive fund growth would be the result of the manner in which support for a CETC is quantified based on the network costs of the incumbent carrier.[9]

Concern about unfettered fund growth results from the Commission's decision, in some cases, to disburse USF cost recovery support on a per-line basis[10] and its insistence that a CETC's

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[8] A local exchange carrier that truly intends to be an ubiquitous service provider (as is expected of an ETC) builds its network to serve all of the customers in the service area that could require service in the foreseeable future or over the life of that network. The costs of building and operating such a network, and consequently the amount of "sufficient" USF that a carrier would require to support the cost of that network and to achieve the intended universal service goals, do not change appreciably based on the actual number of customers served at any one point in time. When a "last-resort" carrier loses customers to a competitive carrier, its network costs remain virtually unchanged, but the observed, calculated cost per-unit (*i.e.*, lines) which the carrier must recover from available sources increases. Moreover, the new competitor provisions additional network that is redundant in some ways to the incumbent's network costs. Consequently, society cannot avoid the overall greater costs that must be supported in those instances where a high-cost area is served by multiple carriers and a second ETC receives support, particularly in an area that has already been shown to present high network cost recovery challenges.

[9] *See, e.g.*, NRTA/OPASTCO at p. 2 (the Commission should deal directly with the real cause of the growing fund size, the use of the ILEC's per-line costs to measure the support payable to CETCs with different costs and characteristics); NTCA at pp. 2-5 (the same per-line support for competitors is not warranted); Montana Telephone Association at pp. 2-3 (CETCs have perverse incentives to game the system for ILEC support); and Telecom Consulting Associates at p. 7 (spiraling fund growth is a function of wireless ETCs who receive support for new lines without a method for determining whether support is needed.).

[10] The flaws in the calculation and disbursement of USF funds based on the number of lines served is also incorporated in the existing plan that applies to non-rural LECs. The mathematical formula used to calculate the costs of networks in high cost areas for non-rural LECs incorrectly assumes that the network is built and operated by a single provider. However, the total cost of two networks, each serving 500 customers in the same high cost area, is considerably greater than a single network serving all 1,000 customers. The Commission's high-cost model does not appear to recognize this conclusion. As a result, high cost support will not

high cost support should mirror the ILECs' high cost support on a per-line basis. The scenario under which "excessive" fund growth would supposedly occur is this: An ILEC loses lines to a competitor, and as a result the ILEC must recover its essentially unchanged fixed costs from fewer lines. Its support, while directed to the recovery of its network costs, is nevertheless now calculated on a per-line basis. As a result of the effectively higher per-line calculated support amount for the incumbent, and under the existing policy which allows the CETC to receive USF disbursements based on the calculated per-line amount of the ILEC, the incumbent ETC receives that which is necessary to recover its high network costs, but the CETC would receive additional support from the fund - *whether or not the increased level of support bears any relationship to the CETC's costs or universal service needs of the public.*[11] Clearly, the current cost recovery mechanism presents opportunities for CETCs to reap unnecessary and unsupportable benefits at the expense of all contributors and their customers.[12] In order to support increased ILEC *and* CETC support, the fund must grow. However, the increased growth attributable to the level of CETC support is artificial and unsustainable as a matter of sound policy.

Ultimately, CETCs' cost recovery should be based on CETCs' own costs. CETCs' need

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be sufficient in divided markets where each carrier achieves a lower economy of scale than would a single carrier providing service to all. Furthermore, the distribution of high-cost support to non-rural LECs based on the number of lines served simply exacerbates the fundamental flaws discussed above. The necessary and sufficient requirement for high-cost support is not directly proportional, on a linear basis, to the number of lines served.

[11] NRTA and OPASTCO correctly observe that the current policy that disburses support dollars to CETCs based on the costs of incumbents creates perverse market entry incentives and uneconomic ETC designations which, in turn, lead to the creation of expensive market distortions that unnecessarily burden ratepayers. NRTA/OPASTCO at 3 and 7-8.

[12] The current system also provides an incentive for competitive carriers to "cream skim" where "cream" customers takes on the new meaning to the competitor -- i.e., a customer who will yield the highest net USF per-line disbursement balanced against the actual cost to serve.

for universal support should be demonstrated, just as ILECs' must demonstrate their costs and associated recovery requirements. Rational, cost-based universal support for CETCs would, by itself and at a minimum, ensure that the USF is properly sized and targeted. The existing record demonstrates the need for the Commission to initiate a new inquiry into the appropriate mechanism for determining USF support for a CETC serving in the same area as a rural incumbent. Pending the Commission's complete and substantive consideration of all of the cost recovery and public policy relationships and goals in this matter, there is no basis to limit artificially the USF, thereby disregarding statutory universal service objectives and real and existing service requirements. Instead, the Commission should initiate a proceeding to examine the more fundamental cost recovery aspects and effects of the available approaches to support the costs of networks in high-cost, rural areas.

II. THE COMMISSION WAS CORRECT IN CONCLUDING THAT FREEZING UNIVERSAL SERVICE FUND HIGH COST SUPPORT IS NOT IN THE PUBLIC INTEREST

A. A FREEZE IS NOT LEGALLY SUSTAINABLE UNDER SECTION 254.

The commenting parties agree with the Commission that Section 254(e) of the 1996 Act requires that universal service support be "sufficient" to achieve the purposes of the Section 254 universal service principles. In the context of support for rural and high cost areas, Section 254(b)(3) means that support should be sufficient to afford access to telecommunications and information services that are reasonably comparable to services available in urban areas at reasonable rates.[13] For the same reasons as the Commission tentatively decided in its *Order*, the freeze on a per-line basis, as proposed by the Rural Task Force, must be rejected because it would

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[13] 47 U.S.C. § 254(b)(3).

arbitrarily limit the size of the fund without regard to whether the level of rural, high cost support to individual carriers would be "sufficient" in accordance with Section 254(e). The counter-productive cost recovery constraints that such a unwarranted per-line freeze would impose would also thwart current efforts by rural telephone companies to upgrade networks in furtherance of the goal to expand access to advanced services in all regions of the Nation.[14] As such, a freeze would violate Section 254(e).[15] On that basis, the Commission correctly rejected the RTF's proposed conversion of support to disbursement based on lines, and the freeze of that support on a per-line basis, for rural, high cost support purposes.

B. THE RECORD DOES NOT SUPPORT A FREEZE.

The Commission also correctly concluded that there was insufficient evidence to support a finding that excessive universal service fund growth is likely to occur as a result of competitive entry into rural study areas.[16] The Commission found instead that the likelihood that competitive carriers' demands on the fund would be great (as a result of "capturing" ILEC lines) was "speculative."[17] Thus, there was insufficient basis for ordering a freeze of rural, high cost support, particularly when the freeze is more likely to be counter-productive to the fundamental universal

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[14] 47 U.S.C. §§ 254(b)(2), (3) and (6).

[15] While Section 254(d) of the Act provides general guidance as to how the Commission may assign carrier contributions to the fund - equitably and on a non-discriminatory basis - the statute does not authorize limiting the fund in order to minimize carrier contributions. In fact, Section 254(d) directs the Commission to seek contributions with regard to the "specific, predictable, and sufficient mechanisms . . . to preserve and advance universal service." 47 U.S.C. § 254(d).

[16] *Further Notice* at para. 211.

[17] *Further Notice* at para. 208.

service goals.[18]

C. THE COMMISSION HAS ALREADY CORRECTLY DETERMINED THAT A FREEZE WOULD BE FAR MORE DETRIMENTAL THAN BENEFICIAL.

The Commission correctly recognized that the detrimental effect of applying a freeze provision during the five-year period far outweighs the purported and speculative benefit of a freeze. Under a freeze, ILECs whose network costs exceeded the amount recoverable from the fund (on the basis of lines served and a frozen support amount per-line) because of stranded investment or upgrading of facilities would have to make up the shortfall. The result of this counter-productive effect would be non-comparable rates for rural users and a curtailment of meaningful investment in networks for the provision of advanced services in rural areas. Cost recovery would have to come either from state funds or from a limited customer base; these resources are finite.[19] This is the kind of predicament that Section 254(e) was intended to address.

Instead of freezing rural, high cost support, the Commission plans to monitor competitive entry into rural areas. This approach was endorsed by several parties.[20] While the AIRIT

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[18] Whether speculative, or not, the cause of any increase, as explained herein, is either the natural result of the costs of networks in high-cost areas built and operated by multiple providers or the result of disbursements to CETCs based both on a per-line count and the effective cost recovery needs of another carrier which may have little, if any, relevance to the cost recovery needs of the CETC.

[19] *See, e.g.,* Comments of the Nebraska Rural Independents at 6-8. Even without the counter-productive effects presented by a per-line freeze provision, the Nebraska companies report that a statewide benchmark rate has already been set, and this rate combined with federal charges result in a basic local service bill that is already 25 percent higher than the national average. *Id.* at 7.

[20] For example, GVNW at 3-4; Telecom Consulting Associates at 7-8; Small Western LECs at 3.

Companies support monitoring of competitive entry (including the impact on the USF, the level of support CETCs receive, and how CETCs use that support), the best means of determining whether high cost support is being directed to the intended recipients in achievement of the intended universal service goals is for the Commission to establish rules based on a rational policy consistent with the statutory requirements for both incumbent ETC and CETC cost recovery. Accordingly, the monitoring of CETC activity envisioned by the Commission should have no effect on ILEC cost support programs and could not justifiably result in the adoption of constraints on any ILEC's network cost support in a misplaced attempt to remedy a problem that is not caused by the ILEC or its support amount. Instead, the monitoring should be used to gather relevant information in support of the development of a rational and effective long term plan.

III. CONCLUSION

Limiting disbursements arbitrarily to high-cost carriers as a means to control USF costs would be contrary to the intended goals. If there arises an issue of unnecessary, spiraling costs, it should be addressed by developing and implementing a rational policy that properly identifies and targets USF support to both incumbent ETCs and CETCs in a manner that achieves and promotes universal service goals. Competitive ETCs serving rural areas should receive only the level of high cost support that is necessary and sufficient to achieve universal service objectives given the CETCs' cost of networks and their actual contribution to the achievement of universal service, as is the case currently with incumbent, rural LECs. Incumbent ETCs similarly should receive USF support dollars at a level that is necessary and sufficient to recover their costs of networks built and operated for the provision of universal services at comparable rates and should not be limited on an ongoing basis to a frozen, per-line amount that has little, if any, relationship to the extent of actual high cost that is in need of cost recovery support.

On balance, freezing support in rural areas on a per-line basis is much more likely to be harmful to universal service goals than the effects of an increasing fund size. If universal service is to be maintained according to the current successful result and is to provide cost recovery support to promote the development of advanced services networks, an increasing fund size will be the inescapable result where multiple providers are promoted by ETC policies in areas already characterized by low economies of scale and high costs. Instead, the Commission should use this proceeding to examine and develop a rational policy approach that can address the fundamental dilemma presented by potential multiple recipients of USF support dollars in high-cost areas with the requirement that the goals of universal service be maintained and advanced. The resolution of the dilemma should not deny high cost support where it is needed and as Congress intended. Converting a rural LEC's high cost recovery to a per-line basis, freezing that per-line support amount, and disbursing support dollars based on lines served, without regard to actual costs of providing universal service, would be fundamentally contrary to the requirements and goals of universal service.

Respectfully submitted,

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